DEPARTMENT OF STATE REVENUE

04-20080401P.LOF
04-20080400P.LOF
04-20080399P.LOF
04-20080398P.LOF

Letter of Findings: 08-0401P, 08-0400P, 08-0399P, 08-0398P
Negligence Penalty
For the Years 2002, 2003, 2004, 2005

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ISSUE

I. Tax Administration – Imposition of Negligence Penalty.

Authority: IC § 6-8.1-10-2.1, 45 IAC 15-11-2.

Taxpayers protest the assessment of negligence penalty.

STATEMENT OF FACTS

Taxpayers (referred to individually as Company A, Company B, Company C, and Company D, or collectively as Taxpayers), are related entities, located in different states. Taxpayers' principal business activity is providing financial services to a broad customer base made up of both commercial and non-commercial customers. Taxpayers' financial services include the maintenance of checking, savings, and other cash deposit accounts, loan initiation and servicing, leasing and other related activities of a financial institution. Taxpayers are included in the combined financial income tax filings of their parent and related subsidiaries.

The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayers for the years 2002, 2003, 2004, and 2005. Taxpayers were assessed additional sales and use tax, interest and penalty through the audit. Taxpayers paid the base tax liabilities and interest, but protested the assessment of penalty. Company A's protest is docketed under 04-20080401P, Company B's under 04-20080400P, Company C's under 04-20080399P, and Company D's under 04-20080398P. Taxpayers were given the option of requesting a hearing on their protests. Taxpayers did not request a hearing, therefore, the determination made in this Letter of Findings is based on Taxpayers' protest letter, dated June 3, 2008, and the Department's audit reports. Taxpayers' protest letter, which states a detailed general protest, does not distinguish discrete issues for the above referenced protests, but rather states the same issues for the four related protests. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Tax Administration – Imposition of Negligence Penalty.

DISCUSSION

Taxpayers protested the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2(b) clarifies the standard for the imposition of the negligence penalty as follows:

> Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.
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> The standard for waiving the negligence penalty is given at 45 IAC 15-11-2(c) as follows:
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> The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:
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> (1) the nature of the tax involved;
> (2) judicial precedents set by Indiana courts;
> (3) judicial precedents established in jurisdictions outside Indiana;
> (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc;
> (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.
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> Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.
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> Taxpayers state in their June 3, 2008, protest letter:

Regardless of the legal entity assessed, the assessments all relate to one of four different functional areas: sales by our payment processing division (FTPS), leasing transactions, sales of previously leased vehicles and purchases by the Bank(s) for their own use.

Specifically, Taxpayers state that FTPS is a premier payment processing system which in Taxpayers' case used 4,000 different services codes to track billing, etc. Taxpayers assert that the Department identified less than 20 service codes in the sample month that had failed to charge appropriate Indiana sales tax. However, the ratio of service codes missed does not necessarily reflect the magnitude of Taxpayers errors because those 20 service codes could theoretically relate to a significant number of transactions. Taxpayers do not point to the particular service codes that were missed.

Regarding leasing transactions, Taxpayers refer to a prior request for waiver of penalty that was granted by the Department (Letter of Findings 04-20070633P). However, in this instance, the Taxpayers were the originators of the leasing contracts and responsible for an exemption being incorrectly "booked" thus resulting in a failure to properly collect sales tax. For example, 80-percent of Company C's assessment resulted from additional sales tax due on leases where there were no exemption certificates.

Regarding sales of previously leased vehicles, Taxpayers describe a program that their parent created whereby employees or other third parties could purchase previously leased vehicles. Each affiliate, such as Taxpayers, administered its own program. One or more of the Taxpayers failed to collect sales tax on these transactions when Indiana's law changed on July 1, 2004, to require collection of sales tax on vehicles purchased in Indiana, irrespective of the ultimate destination of the vehicles. Prior determinations by the Department have consistently held on this issue that ignorance of the law is no excuse.

Lastly, Taxpayers describe the audit of their "consumables" as a "massive undertaking," and state that the taxable expenses in the sample included such things as marketing items, maintenance charges, consulting fees, subscriptions and other miscellaneous expenses. Taxpayers agree that their oversight of consumable purchases during the audit years did not result in a satisfactory level of compliance. For example, 95-percent of Company D's assessment and 60-percent of Company B's assessment resulted from additional use tax on everyday operating supplies, such as, according to the Department's Audit Summary:

During the sample period, the taxpayer purchased advertising items, printing literature, publications, catering charges and other miscellaneous purchases from out-of-state vendors where no sales tax was charged or use tax accrued.

Taxpayers point to significantly increased compliance in the years since the audit due to the introduction of additional high level employees to oversee compliance. Taxpayers efforts in the post audit years are commendable; however, the equitable nature of its argument does not overcome the standard of negligence during the audit years that results in the penalty.

During the audit period, Taxpayers did accrue some use tax, however many items were missed. The fact is that Taxpayers missed ninety-percent of the use tax that should have been self-assessed. Taxpayers have not established, as required by 45 IAC 15-11-2(c), that their failure to pay use tax was due to "reasonable cause" and not due to negligence.

FINDING

Taxpayers' protests are denied.

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An html version of this document.